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December 15, 2010

## **AGENDA ITEM 14**

### **TO: MEMBERS OF THE BOARD OF ADMINISTRATION**

- I. SUBJECT:** Pension System Resumption (PSR) Project Update
- II. PROGRAM:** Pension System Resumption Project and Related Projects
- III. RECOMMENDATION:** Staff Recommends that the Board of Administration Approve an Eleven Month Extension of the Term of the PSR Agreement to September 13, 2013

### **IV. ANALYSIS:**

#### **BACKGROUND**

##### **A. Status Report**

The current status of the PSR and related projects is described in the attached matrix. Staff will present a brief oral update at the meeting. The remainder of this item concerns the term of the Accenture contract.

##### **B. The Prior Extension (One Year).**

The original term of the PSR Agreement with Accenture LLP was five years, commencing on October 10, 2006, and ending on October 9, 2011. At the Board's May, 2010 meeting, the Board agreed to extend the term by one additional year, from October 9, 2011 to October 9, 2012, to accommodate a projected delay in the System Go Live date. At the time of that extension, the new System Go Live date was projected to be September 19, 2011. CalPERS' goals in executing that one-year extension included keeping the Agreement in effect until the System Warranty had expired, and keeping the Agreement in effect until all moneys in a holdback fund had been paid out to Accenture.

##### **C. The System Will Now be Delivered in Three Major Releases.**

The System Go Live date of September 19, 2011 remains unchanged. However, the version of the System that will be released for Go Live ("Release 1") will be missing some less-than-critical items on the System Go Live date. Release 1 will include 85-90% of the business and technical functionality needed by CalPERS to conduct its day-to-day business activities, with the remainder of the needed functionality to be provided over the course of approximately 18 months following Go Live, as follows: in Release 2 (due six months after Go Live) and Release 3 (due one year after Go Live). Some of the functionality deferred until after Go Live consists of items that were not within the scope of the original Agreement, but that have been added by CalPERS during the course of the project. Others of the deferred items were originally within scope, but they were deferred to Release 2 or Release 3 because CalPERS deemed them less critical for Go Live than certain other functionality that CalPERS asked to have included in Release 1.

Following CalPERS' acceptance of Release 3, CalPERS will have the opportunity to test the System further. After Release 3 has been demonstrated to CalPERS' satisfaction that it meets the criteria for Release 3, CalPERS must issue "Final System Acceptance." That event will trigger payout of a 10% holdback fund (discussed below) to Accenture in multiple installments. In case errors are discovered in Release 3 after Final System Acceptance, Accenture must correct them under the System Warranty (discussed below). And if any such errors are significant enough that they would have caused Release 3 not to meet the criteria for Final System Acceptance, had the errors been discovered earlier, CalPERS may suspend any remaining payouts of the holdback fund until such errors have been resolved to CalPERS' satisfaction.

D. The Term of the System Warranty Will Now Encompass Release 3.

Before the parties determined that the System would be delivered to CalPERS in three Releases, the System Warranty would have commenced when CalPERS accepted the System for purposes of System Go Live, and would have ended a year thereafter. Because the System will now be delivered in three Releases, the PSR team has negotiated for a System Warranty term that is tied to completion and acceptance of Releases 2 and 3. The System Warranty will continue until one year after CalPERS accepts Release 2, or six months after CalPERS accepts Release 3, whichever is later. As noted above, Release 3 is scheduled for delivery about one year after Go Live. It is unlikely that Accenture would deliver either Release 2 or Release 3 earlier than scheduled. Therefore, the System Warranty will likely run for 18 months from the System Go Live date, and could run slightly longer, depending when CalPERS accepts the final two Releases.

E. The System Warranty Will Have Expired Within Two Years After System Go Live.

As noted above, the System Warranty will likely run for 18 months after Go Live, although it could run slightly longer if CalPERS takes longer than is now anticipated to accept one or more Releases. There is a very high likelihood that the System Warranty will have expired within two years after Go Live.

F. It is Likely CalPERS Will Engage Accenture to Perform System Support for Two Years From System Go Live at the Renegotiated Rate of \$98 Per Hour.

In the PSR Agreement as originally executed, CalPERS had the option to engage Accenture to perform System support for two years after Go Live at negotiated rates averaging \$135 per hour. The \$135 per hour estimate was based on the mix of skill sets that the parties believed would be required for System Support. Changes in the world economy since 2006 have made that rate uncompetitive. Based on market conditions, CalPERS has negotiated with Accenture for a fixed rate of \$98 per hour. The new rate of \$98 differs from the old “average” hourly rate of \$135, in that the new rate will not change based on the mix of skill sets actually employed by Accenture in performing System Support.

CalPERS will have the option to engage Accenture to perform System Support at this fixed rate of \$98 per hour for the two-year period commencing at System Go Live. CalPERS may exercise the option at any time up to System Go Live. Barring any major change in circumstance, the PSR team expects to recommend for CalPERS to exercise this option.

G. The 10% Holdback Fund Will Likely Have Been Paid Out Within Two Years After Go Live.

The PSR Agreement gives CalPERS the right to retain in a “holdback fund” 10% of each invoice for Deliverables and certain other work, as a mechanism to ensure that Accenture provides all of the services promised. This holdback fund is to be paid out in installments within six months after Final System Acceptance. Because Final System Acceptance is likely to occur approximately 30 days after CalPERS’ acceptance of Release 3, the period during which the holdback fund is scheduled to be paid out will extend approximately seven months beyond acceptance of Release 3. Based on the current schedule, the holdback fund would be fully paid out by late April, 2013 which is about 18 months after Go Live.

H. The PSR Team Recommends an Extension of the Agreement Term until September 13, 2013 to cover System Warranty, Holdback Fund, and System Support Issues.

The PSR team believes it is in CalPERS’ interest to have the PSR Agreement remain in effect until September 13, 2013, so as to cover the System Warranty Period. Extending the term of the Agreement to this date will also keep the Agreement in effect until the holdback has been fully paid out, which is expected to occur in May, 2013. Lastly, keeping the Agreement in effect until that date is appropriate because Accenture will very likely be providing System Support until that date.

Accenture has indicated its willingness to keep the Agreement in effect until September 13, 2013.

If the Board grants this request, CalPERS and Accenture will amend the PSR Agreement to make the new end date of the PSR Agreement September 13, 2013.

**BOARD AUTHORITY**

The Board has adopted policy resolutions (Board Resolution No. 92-04B-4 and Board Resolution 92-04B-1), which together provide that CalPERS’ contracts for goods and/or services shall have terms not to exceed five years, with certain exceptions, including when the

Board has made an affirmative decision that a longer term is necessary to fulfill the Board's duty to serve the interests of CalPERS' members and beneficiaries.

When the Board makes such an affirmative decision, Resolution No. 92-04B-4 mandates that the Board consider the following two factors, and any other factors that the Board may deem prudent under the particular circumstances:

1. The impact of a term longer than five years on CalPERS' interests in obtaining quality services at a reasonable cost; and
2. CalPERS' ability to monitor the performance of any contractor with such a lengthy contract term, and to take corrective action (including expeditious termination of the contract) if necessary to fulfill the Board's fiduciary duties.

### **SUPPORT FOR THE EXTENSION**

#### **1. The Longer Term is Necessary to Fulfill the Board's Duty to Serve the Interests of CalPERS' Members and Beneficiaries.**

- The holdback fund is one of the key mechanisms negotiated by CalPERS in the PSR Agreement for ensuring Accenture's successful completion of the PSR project. The fund has accumulated to an amount that is now nearly \$15.2 million (and by Release 3 is expected to be greater than \$18 million). CalPERS' members and beneficiaries will benefit by keeping the PSR Agreement in effect until the holdback fund has been fully paid out, so that any issues concerning the holdback fund can be resolved using the substantive rules and dispute resolution processes of the PSR Agreement.
- CalPERS' members and beneficiaries will also benefit by keeping the PSR Agreement in effect during the System Warranty Period, so that any issues concerning these subjects can be resolved using the substantive rules and dispute resolution processes of the PSR Agreement.
- It is in the interest of CalPERS members and beneficiaries to avoid disputes over the System Warranty that might arise if any vendor other than Accenture were to perform System Support during the System Warranty Period. It is for this reason that in the original PSR Agreement executed in 2006, CalPERS negotiated for the option to have Accenture perform System Support for two years after Go Live. As noted above, barring any major change in circumstance, CalPERS will likely exercise the option to have Accenture perform System Support for two years. Keeping the Agreement in effect until that System Support work is complete will benefit CalPERS' members and beneficiaries.

2. A Longer Term Will Serve CalPERS' Interests in Obtaining Quality Services at a Reasonable Cost.

- Extending the term of the PSR Agreement to cover the period during which Accenture must meet certain conditions before “earning” the full holdback fund will serve CalPERS’ interests in obtaining quality services at a reasonable cost because such payments are only required to be made, once the pre-negotiated conditions are met.
- Extending the term of the PSR Agreement to cover the System Warranty Period will serve CalPERS’ interests in obtaining quality services at a reasonable cost. The support to be provided by Accenture under the System Warranty is not separately chargeable. It is included within the fixed price of the PSR System.
- As noted above, CalPERS and Accenture have renegotiated the rate for System Support down from an estimated average rate of \$135 per hour to a fixed rate of \$98 per hour. This was done after CalPERS surveyed the market, to gain confidence that \$98 per hour was a fair and reasonable rate for current market conditions.

3. CalPERS' Ability to Monitor Accenture's Performance and Take Any Necessary Corrective Action Will Not Be Diminished under a Longer Term.

- The PSR team anticipates that CalPERS will be intensely focused on the performance of each Release of the PSR System, during the 24 months following System Go Live, in order to address any concerns with the new System that may come to light during this period. CalPERS is also likely to be routinely seeking warranty support from Accenture to resolve such concerns. Accordingly, a lack of focus in monitoring Accenture’s performance under the PSR Agreement during the 24-month period following System Go Live is not likely to be a problem for CalPERS.
- CalPERS will have the ability to take corrective action during the 11-month extension term that is the subject of this Agenda Item. If during this period CalPERS discovered a defect that gave rise to a claim under the System Warranty, and if the Agreement were not in effect, enforcing CalPERS’ rights under the Warranty might be more difficult. Questions could be raised concerning the continuing applicability of various provisions of the Agreement, such as indemnity, limitation of liability, and dispute resolution. Leaving the Agreement in effect during this period would help put such questions to the side.
- As for CalPERS’ rights of termination during the 11-month period, the PSR Agreement has always contained a provision giving CalPERS the right to terminate the Agreement at CalPERS’ option at any time. This provision is not changing. If CalPERS were to terminate the Agreement without cause at a time before Accenture substantially completes its work under the Agreement and is paid for its work, CalPERS might owe Accenture certain payments. But during the 11-month extension period, it is highly likely that Accenture will have already delivered all key Deliverables (including Release 3) and that CalPERS will have incurred obligations

to pay out the holdback because the Deliverables will have met the relevant acceptance criteria. Accordingly, amounts that CalPERS might owe Accenture in a termination during the 11-month extension period likely be much smaller than they would have been earlier during the project.

- The PSR Agreement is also terminable by CalPERS in case of a material default by Accenture. This provision is not changing.

4. Conclusion.

Based on the foregoing, PSR Project Staff hereby requests that the Board authorize an eleven-month extension of the term of the PSR Agreement to September 13, 2013.

**V. STRATEGIC PLAN:**

This item is not a specific product of either the Strategic or Annual Plans, but is part of the regular and ongoing workload of the Pension System Resumption Project.

**VI. RESULTS/COSTS:**

Given the current projected scheduled discussed above for the three Releases of the PSR System, extending the term of the Agreement for eleven months beyond the current end date (for a cumulative extension of 23 months beyond its original five-year term), in order to include the period for payment of the holdback fund, the period for performing the System Warranty, and the period for performing two years of System Support after System Go Live will not result in any cost increase or decrease.

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